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BEFORE THE
POSTAL REGULATORY COMMISSION

Market Dominant Product Prices Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1	:	
	:	**Docket No. R2015-6**
China Post Group—United States Postal Service Multi-Product Bilateral Agreement (MC2010-35) Negotiated Service Agreement	:	

COMMENTS OF UNITED PARCEL SERVICE ON POSTAL SERVICE NOTICE CONCERNING TYPE 2 RATE ADJUSTMENT AND CHINA POST GROUP NEGOTIATED SERVICE AGREEMENT
(September 18, 2015)

United Parcel Service, Inc. ("UPS") hereby provides comments pursuant to Order No. 2669.[1] In that Order, the Commission established the above referenced docket to receive comments from interested persons on a Postal Service Notice of a Type 2 rate adjustment in conjunction with a new market dominant international negotiated service agreement (NSA).[2] UPS believes that the Postal Service's NSA is virtually guaranteed to lose even more money than it currently does and will unreasonably harm the competitive e-commerce marketplace. Further, UPS questions the propriety of the extensive redactions to avoid "commercial harm" for this "market dominant" product. UPS urges the Commission to reject this NSA.

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[1] Order No. 2669, Notice and Order Concerning Type 2 Rate Adjustment and Functionally Equivalent Agreement (Aug. 17, 2015).

[2] United States Postal Service Notice of Type 2 Rate Adjustment, and Notice of Filing Functionally Equivalent Agreement (Aug. 14, 2015) ("Notice").

The Notice concerns the inbound portion of a bilateral agreement with China Post Group (China Post) to be included within the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 (Multi-Service Agreements) product. The inbound portion of the agreement with China Post (China Post 2015 Agreement) establishes negotiated prices for inbound Letter Post in the form of small packets with delivery scanning ("ePackets"). Notice at 3-4.

I. Legal Standard

In its Notice, the Postal Service correctly notes that 39 U.S.C. § 3622(c)(10) provides the appropriate criteria for the Commission's review. Notice at 7. However, in citing the statutory provision the Postal Service claims that

> Under 39 U.S.C. § 3622(c)(10), the criteria for the Commission's review are whether the agreement (1) improves the net financial position of the Postal Service or enhances the performance of operational functions.

Notice at 7. Unfortunately, this is not an accurate description of the statutory provision or its requirements. This statute requires that NSAs, like the one addressed here,

> "(A) either –
>
> > (i) improve the net financial position of the Postal Service *through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service*; *or*
> >
> > (ii) enhance the performance of mail preparation, processing, transportation, or other functions; *and*
>
> (B) do not cause unreasonable harm to the marketplace."

39 U.S.C. § 3622(c)(10) (emphasis added).[3]

[3] What the Postal Service recites in its Notice as the relevant statutory criteria is actually the wording of the regulation at 39 C.F.R. § 3010.40, not the statutory provision, and even the regulation refers explicitly to the statutory provision itself. Thus, the Postal Service tested its Notice against the abbreviated language of the regulation and not the language of the statute from which the regulation is clearly derived.

II. Argument

1. The NSA Does Not Improve the Net Financial Position of the Postal Service

The first criterion in 39 U.S.C. § 3622(c)(10) is whether the classification will "improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution in the institutional costs of the Postal Service." The Postal Service's NSA not only fails to meet either of these two criteria, the Postal Service never explicitly addresses either in its Notice.

The NSA plainly fails to meet both of these criteria. First, the Postal Service's Notice tellingly does not indicate that the ePacket product will result in any reduction of costs for the Postal Service as compared to the provision of its UPU small packet counterpart (hereafter, "Small Packets"). On the contrary, the ePacket will likely incur *more* costs because of additional features, including delivery confirmation and tracking capabilities. Second, the ePackets provided under the NSA will not make any additional contribution to the institutional costs of the Postal Service, because they do not produce enough revenue to cover their own cost of service, and therefore do not generate any contribution at all.

The Postal Service instead argues that providing ePackets under the NSA simply improves its net financial position *overall*, without addressing cost savings or contribution to institutional cost. Even assuming *arguendo* that this were the appropriate test (it is not), the Postal Service has nonetheless failed to show with certainty that providing ePackets under the NSA results in an improved financial position.

The Postal Service contends that, while ePackets admittedly lose money on every piece, they lose slightly less money per piece than Small Packets at terminal dues rates (setting aside for a moment the additional cost of shipment tracking). The Postal Service further contends that, if it were to raise ePacket rates significantly above terminal dues, a mailer (here, China Post) would simply revert to the Small Packet rates, thereby further deteriorating the Postal Service's financial position. These arguments, however, rely on a flawed assumption: that there will be no increased demand for ePackets as a result of its improved features.

If a product loses money on every piece, it is in the best financial interest of the Postal Service to provide as little volume of that product as possible. Between two money-losing products, like ePackets and Small Packets, the Postal Service's financial position is best served by balancing the amount of losses avoided by providing the ePackets against the amount of additional volume demand that is generated by the ePacket's shipment tracking feature. Put simply, if the shipment tracking feature of ePackets results in a demand increase proportionately greater than the avoided losses due to the higher rates, the Postal Service's financial position worsens by offering the ePacket service.

This balancing test is critically important here because the likelihood of increased ePacket volume due to the delivery tracking feature is very high, and the amount of avoided losses through providing ePackets is very low.

It is almost certain that the features of ePackets increase the amount of demand and volume, because delivery tracking is a very attractive and even necessary feature to customers and vendors in the largest growth sector in the shipping industry: online retail, or “e-commerce.” A recent study found that more than half of online shoppers consider tracking an “essential service,” and less than 10% indicated that it is not important to them.[4]

The Postal Service receives very little extra money and mitigates very little loss through the provision of ePackets. In a recent audit, the Office of Inspector General found that the Postal Service received 27 million ePackets from China Post in FY 2012 under the China Post 2010 Agreement. Each ePacket lost $1.10 on average, “a negligible improvement of 5 cents compared to the loss under terminal dues rates.”[5] Thus, by offering the ePacket product, the Postal Service only mitigates its losses from Small Packets by 5¢ each, or 4.4%.

This means that the very likely event of a 4.4% increase in ePackets volume (with the shipment tracking feature) would actually result in the Postal Service losing *more* money than it would have if it provided Small Packets at UPU rates. Unless the Postal Service can demonstrate clearly to the Commission that the volume growth of the ePacket product provided under the NSA will not outpace the losses mitigated through marginally higher pricing, the Commission cannot conclude with certainty that the NSA can meet even the low bar the Postal Service has set for itself.

In fact, in light of the just-announced Memorandum of Understanding between Alibaba and the Postal Service, ePacket volumes are virtually guaranteed to rise drastically. On September 16, 2015, it was announced that the Postal Service had

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[4] United Parcel Service, *A Study of the Online Customer Experience* at 22-23 (Sep. 2013), https://www.ups.com/media/en/gb/UPS_Pulse_of_the_Online_Shopper.pdf.

[5] *Fair Competition in International Shipping: Hearing Before the House Subcommittee on Government Operations* (Jun. 16, 2015) (statement of David Williams, Inspector General, United States Postal Service).

signed a deal with Cainiao, the logistics arm of Alibaba.[6] The announcement stated that the purpose of the deal was "to capitalize on growing opportunities in cross-border e-commerce between China and America by making it easier and more efficient for Chinese companies to sell and deliver goods directly to U.S. consumers." *Id.* The availability of shipment tracking is key to the Postal Service/Alibaba deal: "'As cross-broader [sic] e-commerce grows rapidly, it is critical that we evolve shipping services to the next level, with shorter delivery times and ***easier methods to track a shipment***. The collaboration between Cainiao and USPS will enable us to create new solutions and ultimately improve the overall customer experience,' added Wan Lin [Vice President of Cainiao]." *Id.*

The ePacket is tailor-made for Chinese e-commerce shippers given its size, shipment tracking features, and a price so low the Postal Service actually loses money on it. Not only is an increase in ePacket volumes likely, with the Alibaba deal it is a virtual certainty. Because ePacket volumes are certain to be significantly higher than Small Packet volumes would be, the Postal Service's proposed action is guaranteed to lose it even more money than if it had not signed the NSA. UPS simply cannot fathom why the Postal Service wants to increase its efforts and volumes on money-losing products.

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[6] China's Alibaba and USPS Sign Deal to Increase Cross-border Logistics Services (Sept. 16, 2015), www.businesswire.com/news/home/20150916005594/en/Cainiao-United-States-Postal-Service-Sign-Memorandum.

2. *The Postal Service Has Made No Attempt to Justify the NSA on the Grounds that it Enhances Postal Service Performance*

With regard to § 3622(c)(10)(A)(ii), as the Public Representative noted in its comments, the Postal Service has not demonstrated, nor attempted to demonstrate, that the NSA will "enhance the performance of operational functions" in any way.[7]

3. *The Postal Service's NSA Will Cause Unreasonable Harm to the Marketplace*

Another of the necessary criteria under 39 U.S.C. § 3622(c)(10) is that the proposed adjustment "will not cause unreasonable harm to the marketplace." In its Notice, the Postal Service correctly notes that the "United States' Private Express Statutes also generally prohibit entities other than the Postal Service from carrying inbound international letters commercially after entry at a port in the United States, at least below certain price and weight thresholds. " Notice at 5. This is true for items that are considered exclusive to the Postal Service under the Private Express Statutes, *but ePackets are not covered under the Private Express Statutes*. That rates for ePackets are related to UPU rates does not imply anything about their treatment under PAEA and the Private Express Statutes.

To deal with this difficulty, the Postal Service manufactures its own standard for measuring harm to the marketplace: "the Postal Service is unaware of any private entity that would be able to serve the United States market for small packets with delivery scanning from China on the terms and scale contemplated in this agreement." *Id.* But of course no private entity could serve the domestic U.S. market "on the terms

[7] Public Representative Comments at 3 ("However, the Postal Service provides no discussion, documentation or analysis to support its claim that the identified operational changes 'should enhance' the operational performance of the Postal Service.").

and scale contemplated" in the agreement, *because no other private entity has access to the below-cost terminal dues rates as adjusted by this NSA*.

The Postal Service seeks to avoid this implication by claiming that no competitive harm is present if ePackets are lumped into Letter Post as a whole. Notice at 6 ("Because there is no significant competition in the relevant market when the inbound Letter Post flows are considered in totality, the Postal Service submits that the agreement is unlikely to pose competitive harm to the marketplace."). But the Postal Service cannot claim the lack of harm to this larger "marketplace" when, because of both the statutory monopoly on letter mail and the UPU terminal dues provisions that insulate the UPU cartel from competition, there simply is no "marketplace" at all in the larger Letter Post "market."

In fact, the proposed NSA does harm the marketplace, especially in the United States. "As an indirect result of the arrangements between China Post and the USPS, under which China Post underpays the USPS for lightweight deliveries within the United States, American businesses of all sizes end up paying more than Chinese companies for deliveries to American consumers. In other words, because U.S. domestic delivery rates exceed international termination rates here, Chinese companies end up getting a better deal from the USPS than American businesses."[8] Copenhagen Economics has also demonstrated the harmful economic effects of terminal dues in a paper produced

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[8] *Fair Competition in International Shipping: Hearing Before the House Subcommittee on Government Operations* (Jun. 16, 2015) (statement of Paul Misener, Vice President of Global Foreign Policy, Amazon.com); *see also id.* ("Amazingly, when combined with extremely low bulk shipping rates from China to U.S. transfer points, shipments *from China* to points throughout the United States are often cheaper than shipments *entirely within the United States*. The resulting competitive disadvantage to American businesses of all sizes is as unfair as it is illogical.").

for the Commission. The Commission is surely aware that money-losing and distortionary rates from the Postal Service are enriching Chinese businesses at the expense of U.S. businesses.

4. The Redactions for this "Market Dominant" Product are Inappropriate

The Postal Service also seeks to have its cake and eat it too in thoroughly redacting the Notice. It claims that there is no competition in the marketplace, so the NSA should be approved. On the other hand, the Postal Service argues that the heavy redactions from the text are necessary "due to their commercially sensitive nature," and if there were disclosure, the Postal Service "considers it quite likely that it would suffer commercial harm." Notice, Attachment 1 at 4.

The Postal Service is seeking to have it both ways – no one can compete with this "market dominant" product given its alleged protections in law, yet the Postal Service would suffer grave competitive harm if the PRC made the normal public disclosures about these market dominant rates and terms in the NSA.

III. Conclusion

The Postal Service in its Notice acknowledges that 39 U.S.C. § 3622(c)(10) contains the appropriate criteria for Commission review, but then ignores the statute's language. The NSA will only lose the Postal Service more money, it will not improve its performance, and it will cause unreasonable harm to the marketplace. The Commission should accordingly reject this change because none of the relevant statutory criteria are met. Further, the redaction of all detail in the Notice is inappropriate in this case of a "market dominant" product where the Postal Service argues that competition with their statutorily-protected rates is all but impossible.

Respectfully submitted,

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